UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

TYCO INTERNATIONAL LTD. and TYCO INTERNATIONAL (US) INC., **Plaintiff** v. **L. DENNIS KOZLOWSKI,** **Defendant**	**Case No. 02-cv-7317 (TPG)**

AFFIDAVIT OF KIERNAN J. BELL

I, **Kiernan J. Bell** of Appleby, Canon's Court, 22 Victoria Street, Hamilton HM EX, in the Islands of Bermuda **MAKE OATH** and **SWEAR** as follows:

1. I have been asked by McGuireWoods LLP and Tyco International Ltd to provide an opinion on Bermuda law, and in particular, Bermuda law as it relates to the counterclaim brought by L. Dennis Kozlowski which are set out in the Answer, Affirmative Defenses and Counterclaims of Mr Kozlowski which I have reviewed. For the Court's convenience, the authorities referred to in this affidavit are attached hereto.

Background and Qualifications

2. I am a partner in the firm of Appleby, Canon's Court, 22 Victoria Street, Hamilton HM EX, in the Islands of Bermuda. I obtained my law degree from the University of Birmingham in England in 1992, and was called to the Bar of England and Wales in 1993. I was admitted as a Barrister and Attorney in Bermuda in 1994 and have been in continuous private practice ever since. I was made a partner of the Litigation and Insolvency Department of Appleby, Spurling & Kempe (as it then was) in 2002. I am an elected member of the Bermuda Bar Council,

currently serving as President of the Bermuda Bar Association, which is the governing body for lawyers in Bermuda. My practice covers all aspects of international, commercial litigation and I regularly advise on all areas of Bermuda company and commercial law. I have appeared in civil cases before the Supreme Court of Bermuda, the Court of Appeal for Bermuda and before the Judicial Committee of the Privy Council (Bermuda's highest appellate court) which sits in London, England. I am fully familiar with the administration and practice of all of these Courts and the general system of law which pertains to Bermuda and accordingly, I consider myself qualified and competent to express the views set out in this affidavit.

Bermuda Law

3. As to the application of English law in Bermuda, Section 15 of the Supreme Court Act 1905 provides:

> "Subject to the provisions of any Acts which have been passed in any way altering, amending or modifying the same, and of this Act, the common law, the doctrines of equity, and the Acts of Parliament of England of general application which were enforce in England at the date when these Islands was settled, that is to say on the 11th day of July, 1612, shall be and hereby declared to be in force within Bermuda."

4. The Supreme Court of Bermuda is Bermuda's principal trial court. The Supreme Court of Bermuda is bound by the decisions of the Court of Appeal for Bermuda and the Court of Appeal for Bermuda is, in turn, bound by decisions of Bermuda's highest appellate court, the Judicial Committee of the Privy Council.

5. Strictly speaking the Bermuda's Courts are not hierarchically subordinate to the English House of Lords or other English Courts. However, because Bermuda's common law derives from the common law of England " . . . generally it can be said that the Courts of Bermuda will accept as binding decisions of the House of Lords in common law matters" [1].

6. The Bermuda Courts reserve the capacity to deviate from the English House of Lords decisions if "the social conditions of Bermuda made inappropriate particular path of development taken by the House of Lords against the background of British conditions". [2]

7. However, I know of no instance where a Bermuda court has failed to follow an English House of Lords decision either generally or in the area of the common law or equity.

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[1] *Haley v. Crockwell* (1993) Civil Appeal No. 23 of 1992, Bermuda Court of Appeal.

[2] Ibid.

Further, English Court of Appeal decisions are highly persuasive in the Bermuda Courts and are treated as authoritative statements of the common law and equity. Similarly, English decisions of first instance are persuasive and generally treated as authoritative.

8. As to the interpretation of statutes, the Bermuda court will follow decisions of the English courts in cases where Bermuda has adopted identical statutory language from England.

The US Action

9. I have reviewed the Amended Complaint filed by Tyco International Ltd ("Tyco") and Tyco International (US) Inc ("collectively "the Plaintiffs") against the Defendant, Mr Kozlowski, who was the Chairman and Chief Executive Officer of Tyco from January 1993 until June 3 2002. I have further reviewed the Answer, Affirmative Defenses and Counterclaims filed by the Defendant, the Memoranda of Law filed by both parties on the motion for Summary Judgment, Tyco's Statement of Undisputed Facts, the Executive Retirement Agreement ("ERA") dated 1 March 1999, and the expert affidavits of Mr Saul Froomkin QC sworn on 7 October 2008 and 3 March 2010 respectively.

10. I have been asked to opine on Bermuda law and any applicable legal principles akin to the US legal doctrine known as "the Faithless Servant Doctrine". In addition, I have been asked to consider the defences and remedies available to the Company based on the Counterclaims asserted by Mr Kozlowski.

11. I provide this opinion based on Tyco's Statement of Undisputed Facts and in particular the following facts:

- Mr Kozlowski was a director and officer of Tyco and served as CEO of Tyco from 1991 until 2002.
- Beginning at least January 1 1995 Mr Kozlowski engaged in a scheme to obtain property from Tyco by fraudulent means.
- Mr Kozlowski made false entries in Tyco records with the intent to defraud Tyco.
- Mr Kozlowski stole Tyco funds through unauthorised disbursements to himself and others.
- Mr Kozlowski was charged and convicted of grand larceny, falsifying business records (save for one count of falsifying business records in connection with Tyco's Florida relocation plan), securities fraud and conspiracy against Tyco.
- Mr Kozlowski and Tyco executed the ERA on 1 March 1999.

- Tyco rejected Mr Kozlowski's claim for benefits under the ERA on the basis that he had forfeited his benefits under the ERA through a pattern of disloyal conduct that related back to at least early 1995 and caused great damage to the Company.

12. Mr. Kozlowski, by his Counterclaim in this action seeks to recover for payments he asserts are due to him under the ERA with Tyco, an agreement expressed to be governed by Bermuda law. He also seeks specific performance of his alleged right to indemnification pursuant to Tyco's bye-law indemnity (bye-law 102) which indemnifies directors and officers of Tyco.

13. Tyco states that it is entitled to Summary Judgment on Mr Kozlowski's counterclaims and is entitled to refuse to pay retention benefits to Mr Kozlowski, who acted disloyally, and unilaterally to rescind any agreements induced by Mr Kozlowski's fraud.

The Executive Retirement Agreement ("ERA")

14. The ERA is stated to be governed by Bermuda law. The ERA in the preamble states that the Company entered the Agreement because "the assurance of the continued services and loyalty of Executive is essential to the future best interests of Tyco". I am told that Tyco was not aware, at the time that it entered the ERA that Mr Kozlowski was engaged in a scheme to obtain property from Tyco by fraudulent means and was, at the time, dishonestly defrauding the Company.

15. To the extent that Mr Froomkin, on page 8 of his affidavit, is suggesting that Mr Kozlowski would, as a matter of Bermuda law, be entitled to receive his remuneration under the ERA, notwithstanding his fraud and dishonest breaches of fiduciary duty, I respectfully disagree.

16. Further, to the extent that Mr Froomkin, on page 8 of his affidavit, suggests that Bermuda law has no equivalent to the "Faithless Servant Doctrine" I would also respectfully disagree.

17. The legal principles applicable as a matter of both Bermuda law and English law so far as the consequences of a breach of fiduciary duty are long standing and well established. These principles have been restated very recently by the Court of Appeal in England in *Murad and another v. Al Saraj and another* [2005] EWCA Civ 959 and *Imageview Management v. Jack* [2009] EWCA Civ 63.

18. Simply put, a fiduciary (and as a matter of Bermuda law there is no question but Mr Kozlowski, as a director of a Bermuda company, was a fiduciary to Tyco)[3] who has committed a dishonest breach of fiduciary duty forfeits the right to any remuneration from his principal.

19. This is not a matter of common law but a matter of equity. Principles of equity also provide that if the principal has already paid remuneration to the fiduciary, then the payment is recoverable by an accounting. (See Snell's Equity, paragraph 7-132 and *Imageview* para *51*.)

20. In *Murad*, Arden LJ of the English Court of Appeal sets out the reasons why equity imposes stringent liability of this nature. She held:

"I accept that any rule that makes a wrongdoer liable for all the consequences of his wrongful conduct or for actions which did not cause the injured party any loss needs to be justified by some special policy. But the authorities just cited show that in the field of fiduciaries there are policy reasons which have for a long time been accepted by the courts". (At para 75)

In *Imageview*, Jacob LJ held (paras 49 and 50):

"I have already cited enough to show that the principle is established, see for instance Atkin LJ in *Keppel* ("forfeit any right to remuneration at all"), Lord Alverstone CJ in *Andrews* ("not entitled to recover any commission") Willis J in *Andrews(*'the case ought to be the same whether the commission is has already been paid or whether the agent has to sue for it"), Scrutton LJ in *Rhodes* ("The result may actually be that the employer makes money out of the fact that the agent has taken commission").

The policy reason runs as follows. We are here concerned not with merely damages such as those for a tort or breach of contract but with what the remedy should be when the agent has betrayed the trust reposed in him – notions of equity and conscience are brought into play. Necessarily such a betrayal may not come to light. If all the agent has to pay if and when he is found out are damages the temptation to betray the trust reposed in him is all the greater. So the strict rule is there as a real deterrent to betrayal. As Scrutton LJ said in *Rhodes* at p. 28 "The more that principle is enforced, the better for the honesty of commercial transactions."

21. There is a long line of authorities to the effect that if a fiduciary is dishonest in the performance of his duties he forfeits his remuneration – whether or not that remuneration was faithfully earned in the proper discharge of other duties. (See authorities recited in *Imageview* paragraphs 4-27)

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[3] A description of the fiduciary duty of directors is set out in the judgement of Arden LJ in *Item Software (UK) Ltd v. Fassihi* [2004] EWCA 1244 at paragraphs 41-43, a case relied upon (for a different proposition) by Mr Kozlowski.

22. In the case of *Hippisley v. Knee Brothers* [1905] 1 KB 1 at p. 9, Kennedy J stated the principle as follows:

> "I feel it is difficult to lay down any definite rule upon the subject with confidence, but I would venture to suggest the following: that where the agent's remuneration is to be paid for the performance of several inseparable duties, if the agent is unfaithful in the performance of any one of those duties by reason of his receiving a secret profit in connection with it - and I here use that word "unfaithful" as including a breach of obligation without moral turpitude - it may be that he will forfeit his remuneration, just as in certain cases a captain of a ship might be held in the Admiralty Court to forfeit his wages as a result of misconduct in any branch of his duty as a captain; but where the several duties to be performed are separable, as to my mind they are in the present case, the receipt of a secret profit in connection with one of those duties would not, in the absence of fraud, involve the loss of the remuneration which has been fairly earned in the proper discharge of the other duties." (Emphasis added)

23. In this case Mr Kozlowski was dishonest and fraudulent in the performance of his duties as a director and CEO to Tyco, as established by his multiple convictions. Even if it could be said that Mr Kozlowski earned his retirement benefit under the ERA by virtue of services other than his services he performed fraudulently and dishonestly, he would still, as a result of this principle, be disentitled to all remuneration, whether fairly earned or otherwise.

24. That this is the law of Bermuda is beyond doubt. In the case of *Kelly v. Cooper* [[1992] 3 WLR 936, a case before the Judicial Committee of the Privy Council, on appeal from the Court of Appeal of Bermuda, the law lords had to consider whether an agent's claim for commission was lost due to a breach of duty to the plaintiff. The Privy Council held: "As to the defendant's claim for commission, even if a breach of fiduciary duty by the defendants had been proved, they would not thereby have lost their right to commission unless they had acted dishonestly".

25. It is fair to say that the threshold to be reached before a fiduciary is disentitled to all remuneration is higher as a matter of Bermuda law than may be the case in the United States under the "Faithless Servant Doctrine". However, I think it is quite plain that the dishonest conduct of Mr Kozlowski reaches that threshold and, as a matter of Bermuda law, applying the principles of equity set out above, Mr Kozlowski has forfeited his rights to remuneration from the Company for services whether under his employment agreements, ERA, or any other agreement.

26. At this juncture, I would comment on the authorities referred to by Mr Froomkin in his first affidavit on 7 October 2008. In his affidavit he refers to and relies upon two authorities to suggest that there is no equivalent to the 'faithless servant" doctrine under Bermuda law. Neither authority rebuts or even addresses the longstanding equitable principles recited above in paragraph 20.

Target Holdings Ltd v. Redfern [1996] AC 421

27. I agree with Mr Froomkin that *Target* is a leading case and would be good authority in Bermuda. However, it is not an authority on the point in question. It is concerned with a wholly different equitable remedy.
    - *Target* is not a case concerned with the liability of a fiduciary to account for their own profit or benefit nor is it a case concerned with principles applicable to a dishonest fiduciary. (That this is the case is quite clear from, for example, Arden LJ's judgment in *Murad*, paragraph 72)
    - *Target* is a case concerned with the equitable principles applicable to a breach of trust where a trustee, in breach of trust has parted with trust funds – namely that a beneficiary is entitled to be compensated for any loss that he would not have suffered but for the breach.

Fassihi & Ors v. Item Software (UK) Ltd [2004] EWCA Civ 1244

28. *Fassihi*, as is apparent from Arden LJ's judgment at paragraph 1, was concerned with two points. First, was the first instance judge (Mr Nicholas Strauss QC, not Mr Justice Holman as is stated by Mr Froomkin at paragraph 7) correct in law to hold that Mr Fassihi was in breach of his duties as a director and/or an employee of the respondent in failing to disclose his own misconduct at the time it occurred. Secondly, whether the judge was correct in law in holding that the Apportionment Act 1870[4] did not apply to a claim by an employee to be paid down to the date of his dismissal, even though the date for payment of that remuneration had not then been reached.

29. So far as the second question is concerned, as is apparent from Arden LJ's judgment at paragraph 20, the first instance judge decided the question of whether, having regard to his breaches of duty Mr Fassihi would be entitled to his salary in any event. The first instance Judge decided both these issues in favour of Mr Fassihi, subject to set off of any damages due to the employer and there was no cross appeal. Arden LJ expressly states that she "expresses no

[4] This is an English statute which no applicability in Bermuda

view thereon". (Paragraph 20). The equitable principles recited above simply were not addressed before the Court of Appeal.

30. Finally, the extract quoted in paragraph 7 of Mr Froomkin's affidavit (which actually comes from the judgment of Lady Justice Arden, not Mr Justice Holman as is stated) does not address in any way nor does it derogate from the equitable principles recited above. Arden LJ in *Fassihi* (a 2004 case) is concerned entirely with a question of statutory construction of English legislation and common law remedies. Notably Arden LJ subsequently delivered (in 2005) the leading judgment of the Court of Appeal in *Murad*, a case which, in contrast, was concerned with equitable remedies for breach of fiduciary duty and the scope of the liability to account.

Rescission

31. As a matter of Bermuda law, rescission is a defence available to the Company. The term rescission can have more than one meaning under Bermuda law and in this Affidavit I am referring to the equitable remedy whereby an agreement can be set aside and the parties be restored to the position that they would have been in had the transaction never been made in the first place.[5]

32. Rescission in this context is available where the transaction was procured by a wrongful representation or duress and certain other cases where equity would direct rescission of a transaction on the basis that it was wrongfully procured. A rescindable transaction is therefore voidable and liable to set aside from its inception.

33. Rescission is only available, as a matter of Bermuda law, if both sides of the transaction may be undone. It is my understanding that so far as the ERA is concerned this does not pose any difficulty. The Company has not paid any of the retirement benefit. (See *Guinness plc v. Saunders and another* [1990] 1 All ER 652 at page 665, paragraph 7-126 Snell's Equity)

34. Equity would enable the Company to rescind on multiple grounds.

35. As a matter of Bermuda law, a principal may rescind a transaction that was entered into by the fiduciary in breach of fiduciary duty. In this instance Mr Kozlowski knew in 1999 at the time of executing the Agreement that he was not providing services to the Company honestly but in fact was engaged in dishonestly defrauding the Company. (See Snell's Equity paragraph 7-

[5] There are many defences available to the Company at equity, common law and under Bermuda statute. However, given the admitted unconscionable conduct I am focusing simply on the equitable remedies and defences available to the Company.

120). So far as the test applied for determining dishonesty, it is required that a defendant's knowledge of a transaction had to be such as to render his participation contrary to normally acceptable standards of honest conduct. (See *Barlow Clowes International Ltd (in liquidation) v. Eurotrust International Ltd and others* [2005] UKPC 37, at para 15)

36. Secondly, and in any event, the Agreement could be rescinded on the basis that it was procured by the fraudulent misrepresentation of Mr Kozlowski. In this regard I would observe that I have read the memorandum of law filed by Tyco and can state that Bermuda law, like New York law, allows a party to unilaterally rescind a contract that was induced by fraud or dishonesty. (See Snell's Equity paragraph 13-07)

37. While I think that there may be differences between US and Bermuda law on what constitutes fraud or dishonesty, based on the facts which are not in issue, it seems quite clear that as a matter of Bermuda law, the ERA was induced by fraud. So far as the ERA is concerned, Mr Kozlowski's conduct amounts to fraud by virtue of the following (as to which see *Cavell USA Inc and another v. Seaton Insurance Co and another* [2008] EWHC 3043 at paragraph 76]

- false representations by Mr Kozlowski so far as his intention to act in the best interests of the Company;
- the dishonest suppression of the fact that he was defrauding the Company at the same time he was negotiating the ERA;
- his false representations that the Company's interests were being served by his continued service to the Company, when he was in fact providing those services dishonestly.

38. Mr Kozlowski's dishonest and fraudulent conduct, including his representations (whether express or implied) which induced the Company to execute the ERA I am told occurred in the United States. Accordingly, the question of whether his conduct amounts to fraudulent misrepresentation may under conflict of law principles fall to be considered as a matter of the substantive law of the United States. In this event, the question of available relief for the fraudulent misrepresentation, such as rescission, may also fall to be determined under the substantive law of the United States.

39. However, certainly rescission is a defence available to the Company under Bermuda law when faced with a claim for specific performance or damages for breach, so long as the innocent party has not by its conduct acquiesced in any way. Therefore, if Mr Kozlowski

brought his claim before a Bermuda Court as opposed to before the US Court, it is my opinion that his claim would almost certainly fail. His dishonest conduct and lack of honest belief that he was performing services in the best interests of the Company constitutes a fraudulent misrepresentation which goes to the root of the ERA and would, as a matter of Bermuda law, entitle the Company to rescind the Agreement.

Bye Law Indemnity

40. So far as the bye-law indemnity is concerned, and Mr Kozlowski's asserted right to recover under the bye-law indemnity in respect of liabilities and costs incurred by him as a defendant in an action brought against Mr Kozlowski personally (as well as Tyco) for what I am told amounts to federal securities fraud, it is unlikely he would be entitled to recover.

41. To my knowledge there are no instances of fiduciaries, who have been convicted of dishonest and fraudulent conduct against their principal, who have then sought to rely upon and recover under a bye-law indemnity or any other form of indemnity or exemption provision from their principal. If such a case were to be brought in Bermuda by Mr Kozlowski (and I note that he has not sought to bring such an action in Bermuda) it is my view that on the basis of the same principles of equity recited above, a Bermuda Court would be likely to determine that a Bermuda Company is entitled to expect honest directors and only honest directors can expect to have the benefit of the bye-law indemnity. Applying the principles of equity set out above (paragraphs 17-22 above) a dishonest director would not be entitled to claim a right of recovery under a bye-law indemnity for the same reason that a dishonest director must disgorge profits, give an accounting, repay any remuneration, and forfeits any contractual entitlement to commission or fees.

42. Secondly, as I understand Mr Kozlowski's claim under the bye-law indemnity, he is seeking to assert a claim for specific performance against the Company relying on the bye-law indemnity. As a matter of Bermuda law specific performance is an equitable remedy (based on inadequacy of damages). Again, in light of the undisputed facts a Bermuda Court is likely to find that Mr Kozlowski is not entitled to specific performance on the basis that he does not have 'clean hands'. It is a maxim of equity that '*he who comes into equity must come with clean hands*'. (Snell's Equity paragraph 5-15)

43. Thirdly, I understand Mr Kozlowski seeks to claim under the bye-law indemnity for liabilities and costs incurred as a result of an action brought against Mr Kozlowski personally for violation of US Securities law and securities fraud.

44. If it is determined that his conduct has reached the threshold of fraud or dishonesty he would not be entitled to recover under the bye-law indemnity. Otherwise, (subject to the equitable defences highlighted above) I would agree with Mr Froomkin, that the bye-law indemnity would cover Mr Kozlowski for the liabilities incurred by him as a result of acts done on behalf of the Company which do not amount to fraud or dishonesty.

45. Finally, on page 32 of the Memorandum of Law filed in support of Mr Kozlowski's position, it is stated that "indemnification is prohibited only for 'fraud or dishonesty *in relation to the company*' not for statements made on the company's behalf for which the company is alleged to be equally liable". If it be suggested that the Bermuda Companies Act 1981, in section 98(2) when it states "any provision... between the company and any officer ... indemnifying him against any liability which by virtue of any rule of law would otherwise attach to him in respect of any fraud or dishonesty of which he may be guilty *in relation to* the company shall be void", means that the fraud or dishonest acts must have been 'against' the Company, this is unsustainable.

46. First of all, if the acts or steps in question were not taken in relation to the Company there is no right to seek recovery under the bye-law. This is quite plain from the wording of bye-law 102 which applies to acts done by Mr Kozlowski in his capacity as an officer or in the discharge of his duties as an officer. If those acts were proven dishonest or fraudulent, Mr Kozlowski cannot seek to rely on the indemnity.

47. It is not in issue between the parties that the litigation concerned does make allegations of fraud against Mr Kozlowski (see page 32 of Defendant's Memorandum of Law). It is, therefore, premature to make any determination of any entitlement under the bye-law indemnity.

48. If the allegations of fraud succeed so far as Mr Kozlowski is concerned then, as a matter of Bermuda law, the Company is not permitted to indemnify him as such conduct amounts to fraud or dishonesty. The fact that the Company may also, by virtue of the actions of Mr Kozlowski, be exposed to liability does not assist Mr Kozlowski, though it may give rise to a cause of action by the Company against Mr Kozlowski to seek to recover any loss or damage incurred as a result.

49. Finally, I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

SWORN by the above-named Kiernan J. Bell)
in the City of Hamilton, in the Islands of Bermuda)
this 13th day of April 2010)

Kiernan J. Bell

BEFORE ME:

Notary Public

DAVID G. COOPER, Notary Public
for and in the Islands of Bermuda,
Hamilton, Bermuda.
My Commission is unlimited as to time.

REVENUE BERMUDA
$25